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Washington Consensus or Washington Confusion?

Moisés Naím

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What changes more often, the fashion designs coming from Paris and Milan or the economic policy designs that Washington and Wall Street prescribe to less developed or post-communist countries? Ideas about what makes a country prosperous have always been capricious. During the 1990s, however, the world was under the impression that a clear and robust consensus existed about what poor countries should do to become more prosperous. This delusion owed a lot to the surprising popularity of the term "Washington Consensus," the name that economist John Williamson gave in 1989 to a list of 10 policy recommendations for countries willing to reform their economies.

Although Williamson often went to great lengths to correct those who misinterpreted his approach and made repeated attempts to clarify the nuances of his conceptual framework, his efforts were not enough to compensate for the distortions resulting from the term's global popularity and its frequent misuse. Soon enough, the term Washington Consensus acquired a life of its own, becoming a brand name known worldwide and used quite independently of its original intent and even of its content.

How could such a wonkish moniker have become so popular? For starters, the formulation of the Washington Consensus in the late 1980s coincided with the sudden collapse of the Soviet system. The disenchantment with socialist ideas and central planning, which had likewise pervaded many developing countries outside the Soviet bloc, created an urgent and widespread need for an alternative set of ideas on how to organize economic and political life. In a strange way, the Washington Consensus became an ill-suited and temporary substitute for the all-encompassing ideological frameworks on which millions of people had come to depend.

Unfortunately, the relative simplicity and presumed reliability of the Washington Consensus was not reflected in the experience with market reforms in the 1990s. What was implemented was often an incomplete version of the model, and its results were quite different from what politicians had promised, the people had expected, and the International Monetary Fund and World Bank's econometric models had predicted.

It is clear now that the recipe for prosperity has many ingredients and that their exact quantities, mix, and sequencing are not well known. The search to find widely acceptable syntheses of the public policies that should be used to move countries toward prosperity will continue. Consensus on this subject remains elusive when the discussion moves from general goals to the specific means to achieve them. However, the 1990s left a rich legacy in terms of the areas where action is needed. They can be grouped in five general categories: international economic instability, investment, inequality, institutions, and ideology (the "Five I's"). No matter what shape the future of economic reform takes, any new consensus that emerges must offer sound responses to these challenges.

International Economic Instability

As long as powerful international shocks periodically derail the evolution of reforming economies, it will be difficult to cement whatever gains are produced by the policies now in place. The solution is not to wait for a new "global financial architecture" that would eliminate the effects of the international economic cycle. Nor is it to impose a set of quasi-protectionist obstacles to trade and investment flows that would isolate the economy from external shocks. Rather, countries will have to develop a set of institutions and policies that mitigate the impact of the shocks when they come-and come they will. Examples of such measures are the commitment to strong and well-supervised banking systems and the establishment of an exchange rate regime that diffuses the impact of external shocks.

Investment

Without investment there is no economic growth, and without economic growth there is no sustainable economic policy. Economic growth is not always sufficient to alleviate poverty and certainly is not equivalent to development. Nonetheless, we know that without growth, all other poverty alleviation efforts fall short.

From this perspective, both savings rates and foreign investment become critical variables. Countries with the combination of conditions and policies that are attractive to private investors in general (and foreign investors in particular) will find it easier to fund their social programs and build public support for the policies they are pursuing.

Inequality

Inequality is not a new phenomenon, but in recent years, it has become the focal point of political debates worldwide. This heightened awareness of an increasingly acute problem is bound to pressure governments to take swift actions and show tangible

results in reducing income gaps. In some countries, these efforts will amount to the adoption of policies that sound good but in practice increase inequality and inhibit development. Examples of these are the adoption of protectionist trade and investment policies. These policies often delay growth, increase poverty, and retard any significant progress toward a more just distribution of income. In other countries, the search for ways to minimize inequity may lead to a healthy focus on the urgent need to improve the performance of public institutions, especially those in charge of providing education and healthcare to the poor.

Institutions

Public sector institutions are the black holes of economic reform. In most countries they absorb efforts and investment that yield obscenely low returns to society, distort labor markets, reduce countries' overall productivity, impair international competitiveness, and easily fall prey to vested interests. Public institutions are often at the center of the corruption that corrodes the political system.

Revamping institutions requires a long-term effort and the capacity to tackle difficult political and technical challenges that have no preordained solutions. Moreover, institution building is vulnerable to political discontinuities and economic volatility. Sound macroeconomics and a competitive private sector are necessary. But stability and market reforms are bound to be periodically derailed without a strong and efficient public sector. The real challenge will be ensuring that the urgent need to strengthen institutions (and therefore the political will to allocate massive resources to these initiatives) does not get too far ahead of the limited existing knowledge about how to do this right.

Ideology

The deeply troubled transitions toward market-based economies in the former Soviet Union, Central Europe, and Latin America, as well as the Asian financial crisis, are frequently paraded as examples of the bankruptcy of the neoliberal approaches en vogue during the 1990s. Some reversals in economic reforms have taken place and the speed of reform has certainly slowed down. In reality, however, the backlash against market reforms has manifested itself more in speeches than in actual policies.

But if developing countries are to buy time to make these reforms work, then they must rely on a shared ideological commitment that emerges from within, not one that is imposed from without. Absent a wide social base of support, the acceptance (and stability) of these reforms will depend on a sustained level of high performance that, in

most cases, is unrealistic. Ideology breeds patience-people are willing to give change a chance if they believe that the underlying principles are sound and that it ultimately will benefit them. But if ideology is forced upon a nation, then it is only a matter of time before people become suspicious of its intentions and impatient with its results.

The central challenge for economic reformers is to foster a widely shared commitment to a set of policies that may take years to reach fruition. Their task, however, would be much easier if they were not compelled to conform to a new economic fad every few years. The patience of developing countries will not only be taxed by the volatility of the global economy, but by the volatility of the fickle demands and prescriptions emanating from Washington and Wall Street.